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ABSTRACT

This updated list of content standards covering economics is suggested for states developing their own economics standards. The list outlines the core requirements for basic literacy in economics for grades K-12. The statements are similar to designated content standards from other core subject areas. Key economic concepts describing their basic relationships to the economy are: (1) scarcity and choice; (2) opportunity cost and trade-offs; (3) productivity; (4) economic systems; (5) economic institutions and incentives; (6) exchange, money and interdependence; (7) markets and prices; (8) supply and demand; (9) competition and market structure; (10) income distribution; (11) market failures; (12) the role of government; (13) gross domestic product; (14) aggregate supply and aggregate demand; (15) unemployment; (16) inflation and deflation; (17) monetary policy; (18) fiscal policy; (19) absolute and comparative advantage and barriers to trade; (20) exchange rates and balance of payments; and (21) international aspects of growth and stability. (EH)

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ECONOMICS AMERICA

CONTENT STATEMENTS FOR STATE STANDARDS IN ECONOMICS, K-12

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September 17, 1996

Dear Friend of Economic Education,

In 1994, Congress included economics among the nine subjects in which students will be expected to meet world class standards by the year 2000. The National Council on Economic Education was selected to take a leadership role in this significant project, and we have been developing national standards in economics as part of our comprehensive **Economics**America program. We will be presenting voluntary standards in economics at the American Economic Association meeting in January 1997, and the publication will be available immediately thereafter.

In the meantime, many states have been developing their own state standards as well. In response to their needs, the National Council has updated its highly regarded list of content statements outlining the core requirements for basic literacy in economics. These statements are similar to those undertakings, designated as content standards, currently being advanced in other core subject areas.

We are resisting the temptation to refer to the enclosed statements as standards, because we have not quite completed the important consensus-building and field-testing process. However, we are pleased to be able to assure you that numerous teachers, distinguished economists, and leaders in education, business, and organized labor have already endorsed the statements as the backbone of national standards in economics. They will serve as the foundation for the final standards. The sequence of the statements for each concept is developmentally appropriate for learners, K-12.

Therefore, we hope you will find the enclosed outline helpful. We have also enclosed a copy of our national Directory of affiliated statewide councils and university-based centers for economic education, to assist you in locating outstanding professional colleagues in your area.

Do not hesitate to call on us directly if we may be of further assistance here at the National Council in this very important work.

Sincerely,

Bob Duvall

Robert F. Duvall, Ph. D.
President and CEO
National Council on Economic Education

RD/jm

Encls.

c Carol Jarvis, Executive Director
Council on Economic Education in Maryland

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1140 Avenue of the Americas
New York, NY 10036
Tel: 212/730-7007
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Content Statements for State Standards In Economics, K-12

1. SCARCITY AND CHOICE

1.1 Scarcity is the condition of not being able to have all of the goods and services that you want.

1.2 Economic wants are desires that can be satisfied by consuming a good or service.

1.3 Goods are objects that can satisfy people's wants.

1.4 Services are activities that can satisfy people's wants.

1.5 Scarcity requires people to make choices about using goods and services to satisfy wants.

1.6 People whose wants are satisfied by using goods and services are called consumers.

1.7 People who make goods and provide services are called producers.

1.8 Productive resources are all natural resources, human resources, and human-made resources (capital) used in the production of goods and services.

1.9 Natural resources (also collectively referred to as "land") are "gifts of nature"; they are present without human intervention.

1.10 Human resources (also called labor) represent the quantity and quality of human effort directed toward producing goods and services.

1.11 Capital resources are goods made by people and used to produce other goods and services.

1.12 Scarcity results from the imbalance between relatively unlimited wants and relatively limited resources. There are not enough productive resources to satisfy all of our wants.

1.13 Like individuals, governments and societies experience scarcity because their productive resources are limited and their wants are virtuallly unlimited.

1.14 Entrepreneurship refers to the human resources that assume the risk of organizing other resources to produce goods and services.

1.15 Because federal, state and local governments have limited budgets, they must compare their revenues to the costs of public projects their citizens desire.

1.16 Scarcity of resources necessitates choice at both the personal and the societal levels.

1.17 The quality of labor resources (known as human capital) can be improved through investments in education, training and health care.

2. OPPORTUNITY COST AND TRADE-OFFS

2.1 Opportunity cost is the highest valued alternative that must be foregone because another option is chosen.

2.2 Whenever someone makes a personal decision to use limited resources (i.e., an economic choice), an opportunity cost is incurred.

2.3 Whenever resources are used to produce a particular good or a service, the opportunity cost is not being able to produce the next most valued alternative that could have been made with the same resources.

2.4 Few choices are all-or-nothing propositions; they usually involve trade-offs–i.e., getting a little more of one option in exchange for a little less of something else.

2.5 All decisions involve opportunity costs; weighing the costs and the benefits associated with alternative choices constitutes effective economic decision making.

3. PRODUCTIVITY

3.1 Economic specialization occurs when people produce a narrower range of goods and services than they consume.

3.2 The level of output in an economy can be increased through specialization.

3.3 Productivity refers to a ratio of output (goods and services) produced per unit of input (productive resources) over some time period.

3.4 Specialization and division of labor usually increase labor productivity.

3.5 Productivity can also be increased by providing labor with additional capital goods such as tools and machines to work with.

3.6 Creating new capital goods involves a trade-off of fewer consumer goods or services in the present in return for higher expected productivity in the future.

3.7 Investment in human capital occurs when resources are devoted to increasing the quality of labor resources, thus enhancing their productivity.

3.8 Although investments in capital goods and in human capital can increase productivity, such investments have significant opportunity costs and economic risks.

3.9 Technological change is a leading cause of long-run increases in productivity.

3.10 Technological change depends heavily on incentives to reward innovation on investments in research and development and in capital goods.

3.11 Government expenditures, regulations and tax policy influence productivity.

3.12 Technological change and investments in capital goods and human capital increase labor productivity.

3.13 Living standards are directly related to labor productivity.

4. ECONOMIC SYSTEMS

4.1 The United States economy is organized around a system of private markets in which prices for goods and services are determined.

4.2 An economic system is the institutional framework that a society uses to allocate its resources to produce and distribute goods and services.

4.3 In a tradition-based economic system, production and distribution decisions are largely determined by custom, i.e., the way things have been done in the past.

4.4 In a command economic system, a central authority makes the major production and distribution decisions.

4.5 In a market economic system, the major decisions about production and distribution are made in a decentralized manner by individual households and business firms following their own self-interest.

4.6 Every modern economy is a "mixed" system having some features characteristic of traditional, command, and market economies. The "mix" varies from one economy to another.

4.7 Although wages and prices are found in all economic systems, they are determined in fundamentally different ways in traditional, command, and market economies.

4.8 Economic systems based on tradition do not adapt quickly to change or promote rapid economic growth.

4.9 Economic systems can be evaluated by their ability to achieve broad social goals such as freedom, efficiency, equity, security and growth.

5. ECONOMIC INSTITUTIONS AND INCENTIVES

5.1 Households are individuals or family units which, as consumers, buy goods and services from firms and, as resource owners, sell productive resources to firms.

5.2 Profit-seeking firms are the basic production units in a market economy.

5.3 Profit is the difference between revenues and the costs entailed in producing or selling a good or service; it is a return for risk-taking.

5.4 The hope of earning profit motivates business firms to incur the risks involved in producing goods and services for the market.

5.5 To earn income, households own and sell productive resources in a market economy and also lend money to people or firms.

5.6 Several kinds of specialized economic institutions such as corporations, banks, and other financial organizations are found in market economies.

5.7 In a market economy, the pursuit of economic self-interest is a basic motivation that leads people and businesses to provide goods and services that other people want.

5.8 Economic incentives, including the desire to achieve financial or material gain and to avoid loss, are powerful motivating forces.

5.9 Cultural traditions and customs influence the patterns of economic behavior in a society.

5.10 An economic institution is an enduring organization, practice or relationship established by people to cope with basic economic problems.

5.11 Economic institutions include such organizations as corporations, labor unions, banks, the stock market, cooperatives, and partnerships.

5.12 Private ownership of property is a basic institution in a market economy; property rights are defined, enforced, and limited through the process of government.

5.13 Specific financial and non-financial incentives often influence individuals differently.

5.14 In every economic system, consumers, producers, workers, savers, and investors seek to allocate their scarce resources to obtain the highest possible return, subject to the institutional constraints of their society.

6. EXCHANGE, MONEY AND INTERDEPENDENCE

6.1 Trading goods and services with people for other goods and services or for money is called exchange.

6.2 Money is a good that can be used to buy all other goods and services.

6.3 People voluntarily exchange goods and services because they expect to be better off after the exchange.

6.4 The simplest and most primitive form of exchange is barter – the direct trading of goods and services between people.

6.5 Money is any generally accepted medium of exchange.

6.6 Money eliminates the need for "double coincidence of wants" that must occur for barter to take place.

6.7 Exchanges made through barter face problems of divisibility, portability, and storage that are greatly reduced by the use of money.

6.8 Money has generally replaced barter as a more efficient system for exchange.

6.9 As a unit of account, money can be used to express the market value of different goods and services.

6.10 As a store of value, money retains its buying power and its "liquidity" - i.e., it can easily be traded for goods and services at any time.

6.11 The basic money supply is usually measured as the total value of coins, currency, and checkable deposits held by the public.

6.12 Banks play a key role in providing currency and other forms of money to consumers, and serve as intermediaries between savers and borrowers.

6.13 Greater specialization leads to increasing interdependence between producers and consumers.

6.14 Money encourages specialization by decreasing the opportunity costs of exchange.

6.15 Specialization is limited by the extent of the market for different goods and services.

6.16 When interdependence is present, a single economic unit is ultimately affected by many of the decisions or events that initially affect its trading partners.

6.17 Transaction costs are those costs other than price associated with the purchase of a good or service. When transaction costs decrease, more exchanges will be made, thus enlarging the scope of markets.

7. MARKETS AND PRICES

7.1 A price is the amount of money that people pay when they buy a good or service.

7.2 A market exists whenever buyers and sellers exchange goods and services.

7.3 The market clearing or equilibrium price is the one price at which quantity supplied equals quantity demanded.

7.4 Relative prices refer to the price of one good or service compared to the prices of other goods and services, and are the basic measure of the relative scarcity of a product when prices are set by market forces (supply and demand).

7.5 Relative prices provide the key signals used by consumers and producers to answer the three basic economic questions: What to produce? How to produce it? Who will consume it?

7.6 The circular flow model shows the interactions between households and producers in product and resource markets.

7.7 In a market system, prices provide information to consumers and producers, which encourages the efficient production and allocation of the goods and services consumers demand.

8. SUPPLY AND DEMAND

8.1 If the price of a product increases, quantity demanded will decrease and quantity supplied will increase. If the price of a product decreases, quantity demanded will increase and quantity supplied will decrease.

8.2 Forces of supply and demand determine prices, which are measures of the relative scarcity of different products.

8.3 Demand is the schedule of how much consumers are willing and able to buy at all possible prices in a given period of time.

8.4 Supply is the schedule of how much producers are willing and able to sell at all possible prices in a given period of time.

8.5 Market demand and supply schedules are based on the sum of individual decisions made by all of the individual consumers and producers in a market.

8.6 Prices for different products are interrelated.

8.7 The level of competition among producers or buyers affects supply and demand and prices for different products.

8.8 The demand curve shows an inverse, or negative, relationship between price and quantity demand.

8.9 Demand for a product will normally change (the demand curve will shift) if there is a change in consumers' incomes, tastes and preferences, or the prices of related (complementary or substitute) products.

8.10 The short-run supply curve shows a direct, or positive, relationship between price and quantity supplied because of the law of diminishing returns.

8.11 The supply of a product will normally change (the supply curve will shift) if there is a change in technology or prices of inputs, or in the prices of other products that could be made and sold by producers.

8.12 In the long run, all factors of production are variable.

8.13 Prices set by supply and demand are measures of the relative scarcity of products.

8.14 Shortages or surpluses usually result in price change for products in a market economy.

8.15 When price controls are enforced, shortages and surpluses occur and create long-run allocation problems in the economy.

8.16 Economists describe the demand and supply schedules for various goods and services as inelastic if the quantity responses to a change in price are relatively small compared to the change in price. If the quantity responses are relatively large, demand or supply is described as elastic.

8.17 Demand for products that have few close substitutes and that make up a small part of the consumer's budget tends to be inelastic, as in demand for items that are regarded as necessities. Demand for large expenditure items, products with many close substitutes and items regarded as luxuries tends to be elastic.

8.18 Demand and supply are usually more elastic in the long run than in the short run.

9. COMPETITION AND MARKET STRUCTURE

9.1 A market is a setting where buyers and sellers establish prices for identical or very similar products.

9.2 The level of competition in a market is largely determined by the number of buyers and sellers in the market.

9.3 An industry is made up of all the producers of identical or very similar products in a market area.

9.4 Active competition among sellers results in lower prices and profit levels.

9.5 A monopoly exists when only one producer sells a product that has no close substitutes.

9.6 Competition among buyers of a product results in higher prices for the product.

9.7 Sellers engage in both price and nonprice competition.

9.8 Collusion among buyers or sellers reduces the level of competition in a market. Collusion is more difficult in markets with large numbers of buyers and sellers.

9.9 Oligopoly exists when only a few relatively large producers sell a product that has no close substitutes.

9.10 Cartels are explicit forms of collusion concerning product price, output, service, or sales.

9.11 In the United States laws and government regulations have been adopted to maintain competition. However, many laws and regulations also have had the effect, often unanticipated, of reducing competition.

9.12 The level of competition in an industry is, in the long run, determined largely by how difficult and expensive it is for new firms to enter the market.

9.13 Monopolistic competition exists when many sellers provide similar products that are differentiated to some extent by nonprice competition.

9.14 A monopsony exists when there is only one buyer of a product in a market area; an oligopsony exists when there are only a few large buyers.

10. INCOME DISTRIBUTION

10.1 There are four basic categories of earned income: wages, rent, interest, and profit. Wages and salaries are payments for labor service, rent is the payment for land (natural resources); interest is the payment for capital, including financial capital (money); and profit is the return ..... (entrepreneurship) when the value of sales exceeds the cost of goods and services sold.

10.2 Transfer payments are monetary payments or the direct provision of goods and services made by one party to another without receiving money, goods or services in return.

10.3 The functional distribution of income classifies the income received by individuals and business firms according to the type of productive resources sold in resource markets.

10.4 The personal distribution of income classifies the population according to the amount of income they receive, including transfer payments.

10.5 The functional distribution of income has, over time, reflected changes in the occupational structure of the economy and changing economic conditions related to the business cycle.

10.6 The personal distribution of income has remained relatively stable in the United States over long periods of time.

10.7 Decisions about the distribution of income are made by individuals and firms making exchanges in resource markets, and also through the political process.

10.8 Public policies that can be used to redistribute income include taxation (e.g., progressive or negative income taxes), spending and assistance programs targeted at particular income groups, and programs designed to provide training to workers or to encourage private investments in education or other kinds of human capital.

11. MARKET FAILURES

11.1 Governments provide public goods, due to shared consumption and non-exclusion properties of these products.

11.2 Shared consumption (or non-rival) products are those that can be used simultaneously by more than one person without reducing the amount of the product available for others to consumer.

11.3 A nonexclusive product is one that, once produced, cannot be withheld even from those who do not pay for it.

11.4 Externalities exist when some of the costs or benefits associated with the production or consumption of a product "spill over" to third parties other than the direct producers and consumers of the product. Positive externalities (external benefits result in the underproduction or underconsumption of a product, since not all benefits are reflected in consumers' demand for the product. Negative externalities (external costs) result in the overproduction or overconsumption of a product, since not all costs are reflected in producers' supply of the product.

11.5 A natural monopoly exists when one producer can supply total output in a market at a cost that is lower than if two or more producers divided the production of this output level.

11.6 Because competition cannot serve to regulate price, output and the quality of goods and services produced by natural monopolies, government regulatory agencies are generally established to perform these roles.

11.7 Government can correct for the over- or underproduction/consumption of products affected by externalities through the use of tax policies, subsidies or regulations.

11.8 Perfect competition does not eliminate the problem of market failures.

11.9 Establishing and implementing government policies and programs to correct for market failures is itself a costly activity, and only when the expected benefits of such programs are greater than the costs involved are these actions economically justified. Economic analysis can help determine where market failures are important enough to justify corrective actions by government.

12. THE ROLE OF GOVERNMENT

12.1 Some goods and services are provided by the government.

12.2 The government pays for the goods and services it provides through taxing and borrowing.

12.3 In a market economy, the government defines and enforces property rights and provides standard units of weights, measures, and money.

12.4 Operating a government requires shifting scarce resources from the private sector of the economy to the public sector.

12.5 Other economic roles of government include providing public goods and services; correcting for externalities; maintaining competition; redistributing income; and promoting full employment, stable prices, and reasonable rates of economic growth.

12.6 Different taxes affect different income groups differently. Progressive taxes levy higher tax rates on high-income groups, regressive taxes levy higher tax rates on lower income groups, and proportional taxes levy identical tax rates on all income groups.

12.7 The economic efficiency of a government policy is determined by comparing its costs and benefits.

12.8 Public policies involve economic and political choices and are influenced by both positive and normative concepts as well as by the actions of special interest groups.

12.9 Government policies often affect the well-being of people, businesses, and regions differently as a result of the impact of different kinds of taxes, transfer payments, laws, regulations, and the provision of goods and services the are not used equally by all groups.

12.10 The legal and economic incidence of a tax are often different.

12.11 Benefits of government spending programs are often shifted away from those who were initially intended to receive them.

13. GROSS DOMESTIC PRODUCT

13.1 When purchases are made, goods and services are transferred from businesses to households in exchange for money payments. The money is used by businesses to pay for factors of production: land, labor, capital, and entrepreneurship. This is often depicted in a circular flow diagram.

Same as for preceding grade level, and also:

13.2 Gross Domestic Product (GDP) is a basic measure of economic output. It is used as an indicator of the state of the economy.

13.3 GDP is the total market value, expressed in dollars, of all final goods and services produced in an economy in a given year.

13.4 Nominal GDP is stated in current dollars; thus, an increase in GDP may reflect not only increases in the production of goods and services, but also increases in general prices. GDP can be adjusted for price level changes; the resulting statistic is called "real GDP."

13.5 A country's potential GDP depends on the quantity and quality of natural resources available, the size and skills of the population, and the size and quality of its capital stock.

13.6 Measures of per capita real GDP (real GDP divided by population) are often compared across countries to evaluate the performance of economies and the well-being of their citizens. However, there are limitations to this approach. The measurement of GDP does not account for differences in the types of goods produced, nor for differences in the distribution of income.

13.7 In the United States and other industrialized economies, the rate of economic growth over long periods of time has been relatively steady. However, short-run fluctuations in business activity, called business cycles, are not smooth or completely predictable.

13.8 A recession is said to occur when real GDP declines for a period of at least six months.

13.9 Government may attempt to reduce the fluctuations of the business cycle (stabilize economic activity) by implementing policies that can affect the level of real GDP.

Same as for preceding grade levels, and also:

13.10 GDP is not a perfect measure of how well-off people are.

13.11 GDP can be calculated by adding up all sales of final products. With minor adjustments, the same total is achieved by adding up all income paid to factors of production.

13.12 Disposable income is the income available for use after taxes have bene paid. It is either spent on consumption or saved.

14. AGGREGATE SUPPLY AND AGGREGATE DEMAND

14.1 The relationship between potential aggregate supply and aggregate demand is an important determinant of the levels of unemployment and inflation in an economy.

14.2 Aggregate supply is the total quantity of goods and services produced in an economy in a given time period. Constraints on potential aggregate supply are the quantity and quality of productive resources and the level of available technology.

14.3 Aggregate demand equals consumption, investment, and government spending, plus net exports.

14.4 When aggregate demand is equal to aggregate supply at a level that just employs all available productive resources, the economy is at a full-employment, noninflationary equilibrium.

14.5 When aggregate demand falls below the full-employment level of aggregate supply, production declines and some resources become unemployed in the short run. A reduction in aggregate demand below the full-employment level is the cause of cyclical unemployment.

14.6 When aggregate demand rises above the full-employment level of aggregate supply, competition for productive resources increases and costs and prices rise in the short run. An increase in aggregate demand above the full-employment level is the cause of demand-pull inflation.

14.7 One person's spending becomes another person's income. This process eventually results in a multiple change in aggregate income whenever spending in any one sector of the economy changes.

14.8 Aggregate demand changes when there are changes in consumer, investment or government spending, in net exports, or in price expectations.

14.9 Aggregate supply changes when there are changes in the quantity or quality of resources, productivity, tax policies or profit expectations.

15. UNEMPLOYMENT

15.1 Unemployed people are those who are willing and able to work at current wage rates, but do not have jobs.

15.2 People who are unemployed usually have less income to buy goods and services than those who have jobs.

15.3 Governments provide income to some unemployed workers until they can find jobs.

Same as for preceding grade level, and also:

15.4 The labor force is composed of people age 16 and over who are either employed or actively seeking work.

15.5 The unemployment rate is the percentage of the labor force considered to be unemployed.

15.6 The unemployment rate rises during a recession.

15.7 The standard measure of the unemployment rate is imperfect: it does not include discouraged workers, it does not weight part-time and full-time employment differently, nor does it account for differences in the intensity with which people look for jobs.

15.8 Because of regional economic differences and labor force immobility, unemployment rates differ across the country.

15.9 Unemployment rates differ for people of different ages, races and sexes. This reflects differences in training and skills, as well as discrimination.

15.10 There are four types of unemployment: frictional, seasonal, structural, and cyclical. Different policies may be required to reduce each.

15.11 The rate of unemployment is affected by the costs and benefits of searching for a job.

15.12 Currently full employment is considered to be the employment of about 94-95 percent of the labor force, allowing for frictional unemployment of about 5-6 percent.

15.13 Policies designed to deal with structural unemployment include education and training programs. Not increasing the minimum wage and reducing discrimination might also help.

15.14 Cyclical unemployment may be reduced through policies that stimulate demand (e.g., tax cuts, government spending for public works programs).

16. INFLATION AND DEFLATION

16.1 Inflation is a sustained increase in the average price level of the entire economy; deflation is a sustained decrease in the average price level of the entire economy.

16.2 The Consumer Price Index (CPI) is the most commonly used measure of price level changes. It compares prices in one year with some earlier year (a base year).

16.3 The CPI is not a perfect measure of how inflation affects individual households.

16.4 Inflation creates uncertainty because if affects different groups differently.

16.5 There are two general types of inflation: demand-pull and cost-push. Demand-pull inflation occurs when total spending rises faster than total production. Cost-push inflation occurs when increases in the overall costs of making and selling goods and services raise the price level.

16.6 Demand-pull inflation may result from expansive monetary or fiscal policies, or from expectations of businesses and consumers that prices will rise in the future.

16.7 Cost-push inflation may result from the effects of monopolization in product or factor markets, or from supply shocks.

16.8 A variety of policy options is available to combat inflation; these include monetary and fiscal policies, wage and price controls, antitrust actions, and tax incentives. Alternatively, policy-makers may decide to rely upon automatic adjustment mechanisms.

16.9 Many economists believe that there is a trade-off between unemployment and inflation, at least in the short run. If the government stimulates demand to fight unemployment, inflation is likely to increase; if the government restrains demand to fight inflation, unemployment is likely to increase.

16.10 Stagflation is the combination of high unemployment (a stagnant economy) and high inflation in the same time period. It may result from reductions in aggregate supply.

16.11 People form expectations using both past experience and predictions about present and future government policies. This may have an impact upon the effectiveness of government policy actions.

17. MONETARY POLICY

17.1 Policies that change the size of money supply can be used to promote price stability, maximum employment and reasonable economic growth.

17.2 When the banking system makes loans, the money supply increases; when loans are paid off, the money supply decreases. Banks may lend the money deposited with them that is in excess of the reserves they are required to keep by the Federal Reserve System, the central banking system of the United States.

17.3 Monetary policy refers to actions by the Federal Reserve System that lead to changes in the supply of money and availability of credit.

17.4 One of the tools of monetary policy is raising or lowering the reserve requirement.

17.5 A second tool of monetary policy is increasing or decreasing the discount rate.

17.6 A third tool of monetary policy is open market operations.

17.7 An initial increase or decrease in the money supply has a multiplier effect on the total money supply.

17.8 The Federal Reserve's ability to control the total amount of money in the economy is not complete; the actions of individuals, firms, and foreign investors all influence the money supply.

17.9 Changes in the money supply may influence the levels of spending, employment, prices, and economic growth in the economy by leading to changes in interest rates and in individual and corporate spending.

17.10 One of the limitations of monetary policy is that policies cannot be immediately determined, implemented or evaluated. Instead there exist long and variable lags associated with each stage of the process.

17.11 Federal reserve policies can cause serous economic problems if they are inconsistent or inappropriate.

17.12 The conduct of monetary policy is influenced by political as well as economic conditions.

17.13 Disagreements among economists about the effectiveness of monetary policy can be evaluated using the equation of exchange, which relates the money supply and its velocity (rate of turnover) to the nominal GDP.

18. FISCAL POLICY

18.1 Fiscal policy involves the use of national government spending and taxation programs to affect the level of economic activity in such a way as to promote price stability, maximum employment, and reasonable economic growth.

18.2 Tax reductions and increases in government spending increase aggregate demand and nominal income; tax increases and decreases in government spending reduce aggregate demand in nominal income.

18.3 The budget is balanced when revenues equal expenditures. The government runs a budget deficit when its expenditures exceed its tax revenues. It must then borrow from individuals, corporations or financial institutions to finance the excess of expenditures over tax revenues. When revenues exceed expenditures, the government has a budget surplus.

18.4 The national debt is the total amount of money the government owes; it is the accumulated annual deficits.

18.5 Foreigners and foreign governments may lend money to the United States government to finance its deficits. Repayment of loans from abroad results in a transfer of income from United States citizens to foreign economies.

18.6 Fiscal policies are often a result of political factors as well as economic factors.

18.7 Fiscal policy requires time to affect the economy.

18.8 Fiscal policies may be reinforced or offset by monetary policies.

18.9 An expansionary fiscal policy may "crowd out" private spending if interest rates are raised by the increased government demand for credit.

18.10 Fiscal policy can have a powerful impact on aggregate demand and national income if the government implements the proper policy, at the appropriate time, and at a level commensurate with needs and goals, and if crowding out effects are small.

19. ABSOLUTE AND COMPARATIVE ADVANTAGE AND BARRIERS TO TRADE

19.1 The quantity and quality of productive resources available in different nations vary widely.

19.2 International trade is the exchange of goods and services between people and institutions in different nations.

19.3 Exports are goods and services produced in one nation but sold to buyers in another nation.

19.4 Imports are goods or services bought from sellers in another nation.

19.5 International trade promotes greater specialization, and specialization increases total world output.

19.6 International differences in factor endowments and relative prices are the basis for international trade.

19.7 A nation has an absolute advantage if it can produce more of a product with the same amount of resources than another nation can.

19.8 A nation has a comparative advantage when it can produce a product at a lower opportunity cost than another nation.

19.9 Despite the benefits of international trade, many nations restrict the free flow of goods and services through a variety of devices known as trade barriers which include tariffs and quotas.

19.10 While free trade among nations will raise worldwide production levels and material standards of living in the short run some groups are likely to be hurt by the effects of increased international competition.

20. EXCHANGE RATES AND THE BALANCE OF PAYMENTS

20.1 Different currencies are used in different countries.

20.2 Extensive international trade requires an organized system for exchanging money between nations.

20.3 An exchange rate is the price of one nation's currency in terms of another nation's currency.

20.4 A change in exchange rates can have a significant effect on the flow of trade between nations and on a nation's domestic economy. When the exchange rate between currencies changes, it changes the relative price of goods and services traded by the two countries.

20.5 A nation's balance of payments is an accounting of all international transactions that involve the payment or receipt of foreign exchange.

20.6 Exchange rates can be set in a free market, or established through controls imposed by national governments, or allowed to fluctuate within certain price ranges before triggering government action designed to stabilize the exchange rates between currencies.

20.7 The balance of payments accounts are reported in three sections. These sections distinguish trade involving basic goods and services from trade involving capital resources and financial assets issued by businesses and government, and official transactions of reserve currencies and other assets.

20.8 Countries often run surpluses or deficits in either their current or capital accounts, but the overall balance of payments account for a country must balance.

20.9 The balance of trade figures regularly reported in the media include only the deficit or surplus position of merchandise exports. Therefore, this figure reflects only a small part of a nation's overall balance of payments account.

20.10 Increasingly, we live in a global economy where what is done in this nation affects the rest of the world, and what is done there affects this nation. Economic issues associated with this trend must be analyzed by examining trends in trading levels, investments, foreign exchange values, and changes in public policies affecting these sectors.

21. INTERNATIONAL ASPECTS OF GROWTH AND STABILITY

21.1 Economic growth is a sustained rise in the production of goods and services.

21.2 Technological change and improvements in a society's stock of productive resources promote economic growth.

21.3 The level of real GDP per capita is frequently used to compare the level of economic development in different nations.

21.4 The international transfer of technology and the exchange of productive resources and finished goods and services have led to increased interdependence among nations.

21.5 Increasing international economic interdependence causes economic conditions and policies in one nation to affect economic conditions in many other nations.

21.6 Public polices affecting foreign trade impose costs and benefits on different groups of people; decisions on these policies reflect economic and political interests and forces.